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USDOC FOR FLAVIN AND ITA
MANILA AND LONDON FOR ADB, EBRD USEDS
JUSTICE FOR AFMLS, OIA, AND OPDAT
TREASURY FOR FINCEN AND WORLD BANK,IMF USEDS

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SUBJECT: Shadowy Buyers Near Purchase of Largest Mongolian Bank

Ref: 870 Ulaanbaatar

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¶1. (SBU) SUMMARY AND COMMENT:
There are major concerns about the impending sale of Trade and Development Bank (TDB), Mongolia's largest bank overall and the key bank for foreign exchange and foreign transactions, to a shadowy 100% Mongolian-owned consortium with unknown financing. The IFC and the ADB, which are minority shareholders, plan to sell their shares, fearing a risk to their institutional reputations. The foreign management firm currently running TDB in accordance with international standards may also leave after the sale. The central bank has the power to halt the transaction but, considering its generally poor regulation of other banks, there are serious questions about its will to do this or to ensure that after a sale TDB would continue to meet international standards. The embassy currently uses TDB for banking transactions, and has expressed concerns to the Bank of Mongolia both as a depositor and as an observer worried about the potential negative influences of a bad sale of Mongolia's largest bank for Mongolia's economic development and risks posed to its financial system's stability. END SUMMARY AND COMMENT.

Bank for Sale

¶2. (SBU) Trade and Development Bank is the key Mongolian financial institution servicing international accounts and transactions, holding nearly 70% of Mongolia's dollar and foreign currency deposits. The bank currently nets US$10 million in annual profit, which is a 25% return on its US$40 million in shareholder equity. TDB is currently owned by a consortium led by U.S.-based metals trader Gerald's Metals of Stamford, Connecticut, which owns 64%. The Asian Development Bank (ADB) and the International Finance

Corporation (IFC) each own 7.5%. The remaining 21% is owned by identifiable Mongolian private citizens.

¶3. (SBU) The ADB and IFC only invested in TDB following an extensive review process that certified the bank's financial stability and commitment to following the best international practices for transparency and accountability. TDB is run for the owners by a management team from the Netherlands-based ING Financial Institutions. It was these certifications and management provisions that led the United States Disbursing Officer to select TDB to handle most of its banking arrangements in Mongolia, including disbursement of payrolls and off-site payment for visa processing (scheduled start-up, January 2007). (Note: Embassy has begun to examine alternatives to TDB.) In addition to the US, almost all other multilateral donors (ADB, WB, UN, etc.) use TDB for their financial transactions. According to local banking experts, there is currently no ready substitute to handle the volume of foreign exchange transactions dealt with by TDB. These experts say that a disruption of the bank would be a serious impediment for Mongolia's ability to transact normal business.

¶4. (SBU) Gerald's acquired its majority share in a privatization of the TDB by the Government of Mongolia (GOM). The company has always stated that, being a metals trader, it had no long-term interest in running a bank in Mongolia. It saw the bank as a stepping stone to achieving stability in its metals trading activities, especially in acquiring copper concentrate from Mongolia, and would sell its TDB stake at the first propitious opportunity. This opportunity arose over the last two months in the form of a 100%-Mongolian-owned consortium that seems willing to pay the reported US$70 million purchase price for shares of Gerald's and other stakeholders.

Beware of the Buyers

¶5. (SBU) However, aspects of the deal have raised flags among members of the financial community and TDB's minority shareholders. First to complain was the American CEO of TDB's chief competitor, Khan Bank (KB). Japanese-owned and American-operated, Khan Bank has the largest branch and Mongolian Currency deposit base in Mongolia. Khan Bank had hoped to acquire TDB itself, but found itself locked out by Gerald's decision to sell to the Mongolian consortium. Khan Bank complained to post about the sale, noting that it could neither identify the buyers nor the source of their funds.

¶6. (SBU) Post then went to other shareholders and sources to confirm the sale and its nature. IFC declined to respond to post inquiries about its response to the sale, only confirming that a sale was occurring and that IFC had concerns about it. The ADB was more forthcoming about its concerns. The ADB shareholder representative confirmed that the bank is being purchased by a consortium led by Capitron Bank and Ulaanbaatar Bank. A single press account of the sale also identified these institutions as the prime buyers. (Comment: In post's view, both banks are poorly run with real default loans which are believed to be extremely high. An MP with an unsavory reputation is believed to be the real major owner of Capitron -- a belief lent substantial credence by the MP's reported beating last year of a senior civil servant who is a small shareholder in Capitron, after the official declined to sell the MP his shares.) In addition to these two banks, the ADB and other sources confirmed that a separate block of shares, some 8% held by a Mongolian citizen, had been sold to a woman whose identity no one could conclusively affirm. Overall, neither post nor other credible local sources has been able to identify the purchasers with any certainty.

¶7. (SBU) The European Bank of Reconstruction and Development representative (EBRD) voiced extreme concern about the lack of transparency in all aspects of the sale. The EBRD representative told emboff that he had gone to both the IFC and ADB with a proposal that the EBRD buy Gerald's shares outright and run the bank with the two multilaterals. However, both organizations nixed the idea because, according to the EBRD, they wanted out of an arrangement that no longer suited them.

¶8. (SBU) A TDB executive told post he had been kept in the dark by Gerald's about the specifics of the deal until last week. The executive revealed that the two banks will be minority shareholders and that the bulk of the shares will be purchased by a private Mongolian citizen, whose identity he declined to reveal until the deal was formally signed and approved by all shareholders at a meeting to be held on December 28, 2006.

¶9. (SBU) The executive related that the CEO of one of buying banks had asked him to stay on. The CEO asserted that the new owners wanted to continue to run TBD as Gerald's had, adhering to the best international financial and reporting practices. ADB confirms that the buyers -- through Gerald's -- had expressed the same desire to the ADB, asking ADB to identify a Western management team once ING's contract to run TDB expires. The TDB executive expressed reservations about these sentiments, noting that neither Capitron nor UB City Bank are currently following these practices, and that the private buyer has no apparent experience running a bank.

¶10. (SBU) The TDB executive noted that both the IFC and the ADB had the right to stop the sale if they had reservations of the quality of the buyers, and asserted that therefore the two institutions must have been satisfied with their bona fides. By contrast, the ADB representative noted to commoff that continued association with such murky dealmakers could harm ADB's reputation, and thus that it is better to take the money and depart.

¶11. (SBU) The TDB executive asked how the buyers might address concerns that the USG had about the new ownership. Commoff noted

that much of the problem had originated from the combined failure of Gerald's and the buyers to reach out to their customers in the media and more personally to explain the nature of the sale. The focus on secrecy had created an unhealthy atmosphere of doubt about the real intentions of both buyer and seller, which undercut statements that the new owners wished to continue running the bank according to best practices. Good faith gestures of openness to customers, among which TDB numbers the USG, might lessen our deep concern.

The Position of the Bank of Mongolia on the Sale

¶12. (SBU) On December 20, DCM and Senior Commercial Assistant discussed the proposed sale of TDB with Mongolia (BOM) Head of Supervision Ganbaatar, the country's banking regulator. Emboffs asked about BOM's plans to supervise what promises to be the largest commercial transaction in Mongolia's modern history. Post raised two concerns: the identity of the buyers and their source of funding remains unclear; and the commitment of the buyers to follow best international best practices is unknown.

¶13. (SBU) Ganbaatar acknowledged the validity of these concerns and said that the BOM has been in un-official contact with the sellers and buyers. However, the official said, BOM had not begun its formal review and would not do so until TDB officially requested such a review of the in-coming owners' bona fides. Once the official request was made, the official stated, Mongolian banking law requires each buyer to prove his fitness to run any bank. This requires divulging sources of financing, criminal records, banking experience, etc. BOM's supervision department would lead the review, but would draw heavily on the resources of the newly created Financial Investigative Unit (FIU). (Note: The FIU was created as part of the recently passed anti-money laundering law. However, although it has a new director, the agency has no staff to conduct any reviews at this point and there remains no date for when the FIU will become fully operational.)

¶14. (SBU) Ganbaatar stated explicitly that BOM could ban the sale of TDB to shareholders it found unsuitable, but acknowledged that, over the last six years, BOM has not disciplined any bank for malfeasance or non-compliance with the banking laws and regulations, even in the face of clear evidence of such abuses. Emboffs noted that the bank had a new governor and regulatory team that might take a different tack than the regime of ex-BOM governor Chuluunbat, and that the TDB

transaction would prove an interesting test of BOM's commitment to a well-run banking system committed to best practices. The BOM official agreed that the size, scope, and importance of TDB made their coming assessment of the buyers an important milestone for their agency.

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